

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
FLOYD E. AND HILDA HOWES)

For Appellants: Robert P. Schalk
Attorney at Law

For Respondent: Crawford H. Thomas
Chief Counsel

Richard C. Creeggan
Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest, of Floyd E. and Hilda Howes against proposed assessments of additional personal income tax in the amounts of \$1,619.52 and \$43.20 for the years 1964 and 1965. An appeal was also made with respect to an \$80.98 negligence penalty which was assessed for 1964 but respondent now concedes that the penalty does not apply.

The question presented is whether appellants are entitled to offset certain inheritance tax payments against the proposed deficiencies.

Appellants reside in Watsonville, California. On August 9, 1963, Blanche Howes, appellant Floyd Howes' mother, transferred to appellants by deed of gift approximately 7½ acres of land located in Los Gatos, California. This land was to have been devised to appellant Floyd Howes under the terms of a will executed by his mother on October 4, 1962. Appellants allege that on the date of the gift it was contemplated by the donor and appellants that appellants would subsequently sell the property to a real estate developer who would subdivide and develop the property as residential property, and that the developer would also

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construct a residence on a portion of the property to be sold by the developer to the donor as her permanent residence: In accordance with this arrangement, the Los Gatos property. was sold on September 21, 1963. Under the installment sales contract, the developer was to construct the contemplated residence for Blanche Howes.

On January 1, 1964, Blanche Howes' was hospitalized, and she died on February 2, 1964, due to an apparent stroke. The State Controller included the property in Blanche Howes' estate on the basis that the gift was in contemplation of death. Appellant, as executor of the estate, had filed an inheritance tax affidavit, including the transfer as one made in contemplation of death. Inheritance tax was computed based upon the inclusion of the property and the probate court made and fixed its order- determining and setting the inheritance tax: Appellant did not contest the order and the order became final-by the lapse of time without appeal.

In amended 1963 personal income tax returns filed with respondent and the federal government, appellants eliminated all gain previously reported from the property sales installments received that year, maintaining that since the property was included in the donor's estate it should have a basis equal to its fair market value at the time of its acquisition by appellants. Respondent and the Internal Revenue Service denied this treatment. Since appellants also excluded from their 1964 income installments received in that year, respondent issued-its proposed assessment for 1964. Additional taxes were also proposed for 1965 based upon a recomputation of appellants' 1965 income averaging schedule taking into account the 1964 adjustments.

Appellants now contend the inheritance tax was erroneously paid and may be offset against the California personal income tax liability. It is not denied that the income tax is applicable,

With respect to the possibility of offsetting the inheritance tax paid by appellants, it is first noted that an order of the probate court fixing the tax has the effect of a judgment in a civil action (Rev. & Tax. Code, § 14672) and is conclusive as to such property as is returned in the executor's inventory of the decedent's estate (Rev. & Tax. code, § 14601). If no appeal is taken from the order and it becomes final, its correctness may no longer be challenged. (Estate of Willis, 34 Cal. 2d 782 [215 P.2d 453]; Estate of Off, 146 Cal. App. 2d 516 [304 P.2d 126].)

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In the instant case appellant Floyd Howes, as executor of his mother's estate, filed an inheritance tax affidavit which designated the transfer of the Los Gatos property as a transfer made in contemplation of death. The property was therefore included in computing appellants' inheritance-tax liability and the probate court's order fixed that liability accordingly. No appeal was ever taken from that order and it long ago became final. This board has no jurisdiction to tamper with such a final judgment as to appellants' inheritance tax liability.

In order to defeat the additional assessments of personal income tax here at issue, appellants would next assert the doctrine of equitable recoupment or setoff. Under that doctrine an overpayment of taxes, refund of which is barred by the statute, of limitations, may be offset against a deficiency assessment based upon the same taxable event which gave rise to the overpayment. In our opinion, no such equitable relief is available to appellants under the facts of this case.

The United States Supreme- Court applied the doctrine, of equitable. recoupment in Bull v. United States, 295 U.S. 247 [79 L. Ed. 1421], a case in which the Commissioner of Internal Revenue had determined that a single sum of money was subject to tax under both the federal estate and income tax laws. The Court held that the estate tax had been wrongfully collected and that even though a claim for refund of the estate taxes paid was then barred by the statute of limitations, the taxpayer should nevertheless be allowed to offset the overpayment of estate tax against the income tax deficiency, since the government should not be permitted to recover two taxes on inconsistent legal theories.

Subsequently, in Rothensies v. Electric Storage Battery Co., 329 U.S. 296 [91 L. Ed. 296], the Supreme Court denied such relief to the taxpayer, holding that the doctrine of equitable recoupment should be confined to the facts of the Bull case, i.e., it was limited to situations where "the single transaction or taxable event had been subjected to two taxes on inconsistent legal theories." In such event, "what was mistakenly paid [may be] recouped against what [is] correctly due." (329 U.S. 296, 300.) The Court pointed out that to extend the doctrine further would be to render the statute of limitations meaningless, since "[e]very assessment of deficiency and each claim for refund would invite a search of the taxpayer's entire tax history for items to recoup." (329 U.S. 296, 302.)

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In the instant case the same item of income has not been taxed twice on inconsistent legal theories. Two separate taxable events occurred: (1) Blanche Howes' transfer of the Los Gatos property to appellants on August 9, 1963, and (2) their sale of that property on September 21, 1963. The first transaction gave rise to the inheritance tax paid by appellants, without protest; the subsequent sale of the property resulted in capital gain which was subject to tax under the Personal Income Tax Law. -In our opinion the doctrine of equitable recoupment or setoff simply is not applicable under these circumstances.

In support of their position appellants also make several estoppel arguments which we believe are equally without merit: For-all of the above reasons we conclude that respondent's action in this matter must be sustained.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of **Floyd E. and Hilda Howes** against proposed assessments of additional personal income tax in the amounts of \$1,619.52 and \$43.20 for the years 1964 and 1965, and penalty in the amount of \$80.98 for the year 1964, be modified by cancellation of the negligence penalty imposed for 1964. In all other respects the action of the Franchise Tax Board is hereby sustained.

Done at Sacramento, California, this 24th day of October, 1972, by the State Board of Equalization.

John W. Lynch, Chairman

Robert G. [unclear], Member

Robert [unclear], Member

William L. [unclear], Member

[unclear], Member

ATTEST: W. W. [unclear] Secretary